December 20, 2007

Ms. Gayle Fifield, Administrator III
California Department of Corrections and Rehabilitation
Regional Accounting Office, Northern Region
P.O. Box 942883
Sacramento, CA 94283-0001

Dear Ms. Fifield:

Final Report: Central Coast Regional Accounting Office—Internal Control Review

Enclosed is our final internal control report on the Central Coast Regional Accounting Office (RAO) as of April 5, 2007. The Department of Finance, Office of State Audits and Evaluations (Finance), performed this review to meet the RAO's requirements for the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et seq.

The findings in our report are intended to assist the RAO management in focusing attention on areas of risk, strengthening internal control, and improving operations. The RAO agreed with our findings and we appreciate the RAO's willingness to implement corrective action.

As required by the Financial Integrity and State Manager's Accountability Act of 1983, Government Code 13400, et. seq., please provide us with a corrective action plan within 30 days from the date of this letter. In addition, an updated corrective action plan every 6 months is required until all of the recommendations are implemented. Mail your corrective action plan to:

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

We appreciate the assistance and cooperation of RAO staff and management during our review. In accordance with Finance's policy of increased transparency, the report will be placed on our website. If you have any questions, please contact Kimberly Tarvin, Manager, or Rich Hebert, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations

Enclosure

cc: On following page

cc: Mr. James E. Tilton, Secretary, California Department of Corrections and Rehabilitation
Ms. Heidi Lackner, Director, Division of Support Services, California Department of Corrections and Rehabilitation
Mr. Scott Carney, Deputy Director, Fiscal Services, California Department of Corrections and Rehabilitation
Mr. Timothy Gilpin, Associate Director, Accounting Services, California Department of Corrections and Rehabilitation
Ms. Kim Holt, External Audits Manager, Office of Audits and Compliance, California Department of Corrections and Rehabilitation
Mr. Jaime Corvera, Administrator II, Central Coast Regional Accounting Office, California Department of Corrections and Rehabilitation

An Internal Control Review

Central Coast Regional Accounting Office

Prepared By:
Office of State Audits and Evaluations
Department of Finance

075286006

April 2007

Table of Contents

PREFACE

The California Department of Corrections and Rehabilitation (Department) operates all state adult prisons and juvenile facilities, oversees a variety of community correctional facilities, and supervises all adult and juvenile parolees during their reentry into society. The Department's adult program includes 33 institutions which span the state from Pelican Bay State Prison in the northwest corner of California to Centinela State Prison near the United States/Mexico border.

The Department's Sacramento Headquarters and eight regional accounting offices perform the fiscal administrative functions related to the adult institutions. Many of these accounting and administrative functions are consolidated within the regional accounting offices, while some functions, such as inmate trust and stores accounting, are performed at the institutions. The Department's fiscal administrative structure enhances its ability to provide effective fiscal management through centralization of institutions' accounting records, application of consistent accounting procedures, monitoring of fiscal activity, and retention of trained and qualified staff.

The Central Coast Regional Accounting Office (RAO) serves the California Men's Colony, Avenal State Prison, Pleasant Valley State Prison, Salinas Valley State Prison, and the Correctional Training Facility. The internal control review of the RAO was performed in conjunction with a review of the fiscal operations at these institutions. Separate reports for the RAO and the Institutions are being issued. The findings in this report pertain to the RAO's controls over the processing and preparation of institution transactions and financial statements.

State managers are required to maintain internal control over the programs they administer. Internal control is as a process designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. This definition of internal control includes five interrelated components:

- *Control environment* sets the tone of an organization and influences the control consciousness of its staff. It is the foundation for all other components of internal control and provides discipline and structure.

- *Risk assessment* is the entity's identification and analysis of relevant risks to the achievement of its objectives and forms a basis for determining how risk should be managed.

- *Control activities* are the policies and procedures that help ensure management directives are carried out.

- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.

- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of the internal control review was to assist the Department in complying with the Financial Integrity and State Manager's Accountability Act of 1983, Government Code Section 13400, et seq. Specifically, the Department of Finance, Office of State Audits and Evaluations, assisted the Department in determining whether the RAO's: (1) assets are safeguarded from unauthorized use or disposition, (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements, and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, certain other state laws and regulations, and the Institution's and Department's policies and procedures.

The review did not include an evaluation of the efficiency or effectiveness of the RAO's operations or the accomplishment of program goals or objectives.

This report is intended for the information and use of RAO and Department management. It is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

STAFF:

Kimberly Tarvin, CPA
Manager

Rich Hebert
Brandon Nunes
Supervisors

Lisa Negri
Randy McClendon
Cindie Lor
Mary Tesema

Executive Summary

The review of the Central Coast Regional Accounting Office's (RAO) internal control indicated that controls were in place and working as intended for budget, cash receipts, accounts receivables, cash disbursements, personnel and payroll, property, financial reporting, and contracts. Specifically, the RAO has adequate controls to ensure budget transactions are accurately recorded. Cash receipts are correctly recorded and deposited. Receivables are established for amounts due. Cash disbursements are made for allowable purposes. In addition, controls over personnel and payroll functions are sufficient to ensure the reliability and integrity of payroll data. Property is properly recorded and adequately safeguarded. Financial reporting is accurate and contracts are appropriately approved. However, controls could be improved to reduce the risk of errors, irregularities, and material misstatements in the areas of: information technology, purchasing, and revolving fund expenditures.

The findings in this report are based on fieldwork performed between August 28, 2006 and April 5, 2007. The findings and observations were presented to the related units and RAO management throughout the fieldwork and at an exit conference held April 5, 2007.

This review was limited to the RAO's accounting and administrative functions and did not include the accounting and administrative functions performed at the Department of Corrections and Rehabilitation Headquarters (Headquarters) or at the correctional institutions. Because the institutions are primarily responsible for inmate trust and the support warehouse activities, these activities were not reviewed. Additionally, the contracts review was limited because contracts over $5,000 are processed by Headquarters. The review did not include an evaluation of the efficiency or effectiveness of the Institution's operations, or the accomplishment of program goals or objectives.

Reportable Conditions

Information Technology: The RAO's controls over access to the CALSTARS system are not adequate. Specifically, three employees have incompatible CALSTARS access resulting in a separation of duties weakness. In addition, four of five daily batch reconciliations recorded in February 2007 did not balance.

Purchasing: The RAO's controls are inadequate to ensure the proper recording and liquidation of encumbrances.

Revolving Fund: The RAO's controls over salary advances issued from the revolving fund are weak, resulting in salary advances not being collected in a timely manner.

For further analysis of these weaknesses, see the *Findings and Recommendations* section of this report. This report is intended to assist the RAO management in focusing on areas of risk, and in strengthening internal control and improving operations.

AUDITOR'S REPORT

Ms. Gayle Fifield, Administrator III
California Department of Corrections and Rehabilitation
Regional Accounting Office, Northern Region
P.O. Box 942883
Sacramento, CA 94283-0001

The Department of Finance, Office of State Audit and Evaluations, reviewed the internal control of the Central Coast Regional Accounting Office (RAO) as of April 5, 2007, for conformity with Government Code Section 13400, et seq. This review included gaining an understanding of internal control through observations and interviews, evaluating the design and operating effectiveness of the internal control, and performing other procedures deemed necessary.

The RAO's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400, et seq., includes documenting internal control, communicating control requirements to employees, and ensuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control are to provide reasonable, but not absolute, assurance of the following:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Based on the review of the RAO's internal control as of April 5, 2007, certain matters were noted involving the internal control and its operation that are considered to be reportable conditions. Reportable conditions involve matters relating to significant deficiencies in the design or operation of the internal control over financial reporting that could adversely affect the RAO's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition that precludes the RAO's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. We believe that none of the reportable conditions is a material weakness. The reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended for the information and use of RAO and Department management. It is not intended to be and should not be used by anyone other than the designated parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

Janet I. Rosman, Assistant Chief
Office of State Audits and Evaluations
(916) 322-2985

April 5, 2007

The review of the Central Coast Regional Accounting Office's (RAO) accounting and administrative controls in effect as of April 5, 2007, indicates that most controls were functioning as intended. Specifically, no reportable conditions were identified for the budget, cash receipts, accounts receivables, cash disbursements, personnel and payroll, property, financial reporting, and contracts activities. However, some controls were not operating as intended, and corrective action is needed to safeguard assets from loss. Left uncorrected, these weaknesses could increase the risk that material errors and irregularities could occur and remain undetected.

Information Technology

Effective internal control is necessary to safeguard agency information from unauthorized acquisition, use, or disposition. The following internal control weaknesses over the RAO's information technology were identified.

FINDING 1 **Inappropriate CALSTARS Access**

Condition: Three staff have inappropriate access to the California State Accounting and Reporting System (CALSTARS). One individual has CALSTARS access to prepare and reconcile checks. Another individual has CALSTARS access to input disbursements and receipts. A third individual has access to blank check stock and inputs disbursements. As a result, a risk exists that errors or misappropriation of assets could occur and remain undetected.

Criteria: State Administrative Manual (SAM), Section 8080.1, states that agencies with automated accounting systems should ensure appropriate separation of duties by not assigning staff to perform more than one of the following duties:

- Input disbursement information
- Control blank check stock
- Input receipt information
- Perform reconciliations

Recommendation: Change the CALSTARS access designations to ensure that staff do not have access to incompatible functions.

FINDING 2 **Daily Batch Reconciliations Out of Balance**

Condition: Of the 5 reviewed daily batch reconciliations prepared between February 20 and February 26, 2007, 4 (80 percent) did not balance. Inaccurate or incomplete batch reconciliations cause improper posting of transactions to CALSTARS which may result in inaccurate financial statements.

Criteria: CALSTARS Procedures Manual, Chapter 18, pages 1 and 2, state that daily system reconciliation is necessary to ensure that all financial transactions and error corrections are successfully processed through the system. Daily batch reconciliation includes comparing total transactions submitted to the total of transactions processed. Any differences must be investigated and corrected so that the accounts remain in balance.

Recommendation: Provide training to staff to ensure that the daily batch reconciliations are completed properly and any differences are investigated and corrected promptly.

Purchasing

Effective internal control over purchasing is necessary to ensure that the RAO acquires only those goods and services that are authorized and necessary for effective operations. The following internal control weakness over the RAO's purchasing was identified.

FINDING 3 **Inaccurate Purchase Estimate Encumbrances**

Condition: Of 7 purchase estimates reviewed, 6 (76 percent) were inaccurate as follows:

- Encumbrance balances for 3 purchase estimates were not reduced by subsequent payments.
- An encumbrance was not recorded for 2 purchase estimates.
- The supporting documentation could not be located for 1 purchase estimate that was encumbered.

Failure to accurately record encumbrances and their liquidations may lead to misstatements in the financial statements.

Criteria: SAM, Section 10806, requires that the accounting office record purchase estimates as encumbrances. As payments are made against outstanding purchase orders, encumbrance balances should be correspondingly reduced.

Recommendation: Provide training to staff to ensure that encumbrances and liquidations are accurately recorded.

Revolving Fund

Effective internal control over the revolving fund is necessary to ensure that the RAO safeguards monies administered through this funding mechanism. The following internal control weakness over the RAO's revolving fund was identified.

FINDING 4 **Salary Advances Not Collected Timely**

Condition: The collection procedures and efforts to collect salary advances are inadequate. Of $102,009 reviewed salary advances outstanding over 60 days, $50,503 remains uncollected and requires further collection activities. These salary advances were established between January 2003 and November 2006. Failing to collect salary advances in a timely manner increases the risk that the amounts will not be collected and state funds will remain unavailable for other uses.

Criteria: SAM, Section 8776.6, allows for collections from current employees to be made by installment through payroll deduction if the employee does not agree to repay the amount owed in a lump sum or does not respond to a written notification within the designated time period.

SAM, Section 8776.7, provides guidelines for collection procedures to ensure prompt collection of accounts receivable from former state employees. Furthermore, if all reasonable collection procedures do not result in repayment, agencies should request discharge of accountability for uncollectible amounts owed.

Recommendation: Apply collection procedures promptly and systematically to recover overdue salary advances.

ACCOUNTING SERVICES
P.O. Box 187019
Sacramento, CA 95818-7019

Ms. Diana L. Ducay, Chief
Office of State Audits and Evaluations
California Department of Finance
300 Capitol Mall, Suite 801
Sacramento, California 95814

Dear Ms. Ducay:

Enclosed are the responses to the draft internal control report on the Central Coast Regional Office (RAO) as of April 5 2007. We appreciate your staff assistance in reviewing and evaluating the internal controls of the RAO. The objective of the Department of Corrections and Rehabilitation (CDCR) is to comply with the Financial Integrity and State Manager's Accountability Act of 1983 Government Code Section 13400, et seq. Your findings and recommendations will assist the RAO management in focusing on areas of risk, and in strengthening internal controls and improving operations.

The findings outlined in the report have been corrected as noted in the attached responses. If you have any questions regarding this matter, please contact Jaime Corvera at (805) 237-4775.

Sincerely,

Original signed by:

TIMOTHY GILPIN
Associate Director
Accounting Services

cc: Scott R. Carney, Deputy Director, Office of Fiscal Services
Gayle Fifield, Accounting Administrator III, Accounting Region North
Annemarie Reno, Accounting Administrator III, Accounting Region South
Jaime Corvera, Accounting Administrator II, Central Coast RAO
Edna Murphy, Accounting Administrator II, Accounting Standards Branch

Information Technology

Effective internal control is necessary to safeguard agency information from unauthorized acquisition, use, or disposition. The following internal control weaknesses over the RAO's information technology were identified.

FINDING 1 Inappropriate CALSTARS Access

Condition: Three staff have inappropriate access to the California State Accounting and Reporting System (CALSTARS). One individual has CALSTARS access to prepare and reconcile checks. Another individual has CALSTARS access to input disbursements and receipts. A third individual has access to blank check stock and inputs disbursements. As a result, a risk exists that errors or misappropriation of assets could occur and remain undetected.

Recommendation: Change the CALSTARS access designations to ensure that staff do not have access to incompatible functions.

Response: We agree and have taken steps to resolve this issue. The person that reconcile checks no longer has CALSTARS access to prepare checks. This was an oversight where access was given during the creation of new organizations, but the person reconciling the checks never actually prepared checks.
Access was corrected for the person having access to input disbursements and receipts. This access was established to provide back up during absences of the check writer. In accordance with separation of duties, the new back-up check writer does not input receipts.

The person inputting disbursements no longer has access to blank checks.

FINDING 2 Daily Batch Reconciliation Out of Balance

Condition: Four of 5 reviewed daily batch reconciliations prepared between February 20 and February 26, 2007 (80 percent) did not balance. Inaccurate or incomplete batch reconciliation causes improper posting of transactions to CALSTARS which may result in inaccurate financial statements.

Recommendation: Provide training to staff to ensure that the daily batch reconciliations are completed properly and any differences are investigated and corrected promptly.

Response: We agree and have taken steps to resolve this issue. The person that performed the daily batch reconciliation in February was new to the assignment. Since then, this person has been properly trained and the supervisor performs monthly random audits of the daily batch reconciliation to ensure correctness.

Purchasing

Effective internal control over purchasing is necessary to ensure that the RAO acquires only those goods and services that are authorized and necessary for effective operations. The following internal control weakness over the RAO's purchasing was identified.

FINDING 3 Inaccurate Purchasing Estimate Encumbrances

Condition: Of 7 purchase estimates reviewed, 6 (76 percent) were inaccurate as follows:

- Encumbrance balances for 3 purchase estimates were not reduced by subsequent payments.
- An encumbrance was not recorded for 2 purchase estimates.
- The supporting documentation could not be located for 1 purchase estimate that was encumbered.

Failure to accurately record encumbrances and their liquidations may lead to misstatements in the financial statements.

Recommendation: Provide training to staff to ensure that encumbrances and liquidations are accurately recorded.

Response: We agree and have taken steps to resolve this issue. In December of 2006, this office lost the 1st and 2nd level supervisor from payables as well as six accounting staff also from payables. Most of the vacancies were filled by mid February 2007, and everyone was in a learning stage during the audit. The payables/encumbering unit is currently staffed and properly trained. The review of each encumbered purchase order is taking place on a regular basis. The 1st line supervisor performs weekly audits of staff bins and payment logs to ensure that staff is following proper procedures.

Revolving Fund

Effective internal control over the revolving fund is necessary to ensure that the RAO safeguards monies administered through this funding mechanism. The following internal control weakness over the RAO's revolving fund was identified.

FINDING 4 Salary Advances Not Collected Timely

Condition: The collection procedures and efforts to collect salary advances are inadequate. Of $102,009 reviewed salary advances outstanding over 60 days, $50,503 remains uncollected and requires further collection activities. These salary advances were established between January 2003 and November 2006. Failing to collect salary advances in a timely manner increases the risk that the amounts will not be collected and state funds will remain unavailable for other uses.

Recommendation: Apply collection procedures promptly and systematically to recover overdue salary advances.

Response: We agree and have taken steps to resolve this issue. Currently the RAO has $121,915 of outstanding salary advances over 120 days that are for separated employees. The RAO uses a collection agency to locate and collect for these accounts receivables. Procedures have been strengthening to ensure that the institutions do not release final payments to separating employees unless the RAO provides clearance that no outstanding recievables exist.

The current outstanding salary advances over 60 days and less then 120 days is $17,986. These are for current employees and we are working very close with the institutions not to have any salary advances over 60 days.